Cost Allocation Mechanism

California Public Utilities Commission

Policy & Planning Division

Stephen St. Marie
Principal Author
POLICY AND PLANNING DIVISION

Marzia Zafar
Director
POLICY AND PLANNING DIVISION

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Rationale for this Paper & Next Steps

This paper is intended to be an informal first step toward a potential solution for all parties on matters related to the electricity Cost Allocation Mechanism (CAM). Policy & Planning Division has worked with the assigned Commissioner's office and the assigned Administrative Law Judge for the Long-Term Procurement Plan proceeding (LTPP). Our collective hope is to begin an informal process led by Policy & Planning Division to gauge whether parties can come to a consensus on a possible solution regarding CAM. Since Policy & Planning Division normally does not get involved in active proceedings before the Commission, it is more appropriate for this group to conduct the informal first step. As such, we have stated in this paper a possible solution.

This paper will be posted to the Commission website, and we also will send it to relevant interested stakeholders. Then PPD will hold individual meetings to discuss in earnest various stakeholders' concerns and possible ideas for a solution and/or a modification to what we have suggested. Once these individual meetings are completed, we may modify this paper and hold workshops. If it seems that a solution is possible, then PPD will turn the issue over to the assigned Administrative Law Judge and the assigned Commissioner's office for the LTPP preceding in order for a record to be built and formal comments to be received. The intention is to create a more streamlined process and not to waste parties' efforts.

Executive Summary

The purpose of this short paper is to review and re-evaluate the Cost Allocation Mechanism (CAM), a regulatory process mandated by the California Public Utilities Commission (Commission or CPUC) to see whether it is fairly apportioning costs and to consider whether the CAM could be modified in some way that, while still meeting its objectives, would better satisfy parties, including Community Choice Aggregators (CCAs), Electric Service Providers (ESPs), and the Investor-Owned Utilities (IOUs) whose job it is to represent the interests of bundled ratepayer customers. This memorandum is a short exposition of the issues, and it provides a suggested alternative.

Background on Cost Allocation Mechanism

The CAM is a regulatory process for allocating capacity costs of utility procurement across all benefitting customers. Conceived in a 2004 decision,[1] adopted in a 2006 decision,[2] affected by changes in law,[3] and continuing to be adapted to new issues and circumstances even in 2014, the CAM remains a contentious issue in law and regulation.[4] It is a fixture of the Commission's Long Term Procurement policy and is based on the principle that the costs and benefits of new generation should be shared by all benefitting customers in an investor-owned utility's service territory. The history and current status of the CAM are presented in an extensive discussion in Decision D.13-02-015.[5] [6] That decision of only last year reaffirmed that "The cost allocation mechanism established … and refined … *remains reasonable for application in this proceeding without modification* and is fair and equitable as required by [public utilities

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[1] In Decision (D).04-12-048, Proceeding (R).04-04-003, the Commission authorized the investor-owned utilities to recover stranded costs associated with new purchased power agreements and utility-owned generation from all customers, with the goal of providing the need for reasonable certainty of rate recovery.

[2] Decision (D).06-07-029, Proceeding (R).04-04-003, adopted the Cost Allocation Mechanism, which allows the costs and benefits of new generation to be shared by all benefitting customers in an investor-owned electric utility's service territory.

[3] Senate Bill 695 of 2009 (Statutes of 2009, chapter 337) and Senate Bill 790 of 2011 (Statutes of 2011, chapter 599).

[4] Most recently, issues relating to the CAM have been litigated in Rulemaking (R).12-03-014 and adjudicated in Decision (D).13-02-015.

[5] Decision (D).13-02-015, pp 98-101.

[6] Marin Energy Authority has filed an Application for Rehearing of Decision (D).13-02-015, filed March 15, 2013.

code] Section 365.1(c)(2)(A)-(B)."[7] The decision went on to order the Southern California Edison Company to "allocate costs incurred as a result of procurement authorized in this decision and approved by the Commission *consistent with the cost allocation mechanism approved* in [previous decisions of the Commission]."[8]

The Point of View of Community Choice Aggregators and Direct Access Customers

Community Choice Aggregators (CCAs) and both Electric Service Providers (ESPs) and their Direct Access customers (DAs) chafe under the burden of supporting the CAM. In 2006, some parties to the Commission's Rulemaking to Integrate Procurement Policies and Consider Long-Term Procurement Plans proposed that Load-Serving Entities (LSEs) that can demonstrate that they are fully resource adequate over a long time period be allowed to opt-out of the CAM. While the Commission found the idea appealing, it declined to adopt an opt-out mechanism for "the reality is that we have no viable enforcement program or mechanism for doing so."[9] The Commission once again specifically rejected an opt-out mechanism in 2010.[10] In the most recent proceeding, the Alliance for Retail Energy Markets, along with Direct Access Customer Coalition and Marin Energy Authority (MEA), asserted that the Commission's goal should be to minimize CAM procurement. They proposed a driving peak/decreasing load two-step mechanism for the purpose of reducing the CAM burden.[11] Again, the Commission rejected any change.[12]

[7] Decision (D).13-02-015, Conclusion of Law 21, p 130, *emphasis added*.
[8] Decision (D).13-02-015, Ordering Paragraph 15, p 136, *emphasis added*.
[9] Decision (D).06-07-029 in Rulemaking (R).06-02-013, p 35. Finding of Fact 26, p. 57.
[10] Decision (D).10-06-018 in Rulemaking (R).05-12-013, "Decision on Phase-2 Track 2 Issues: Adoption of a Preferred Policy for Resource Adequacy."
[11] Decision (D).13-02-015, p 102-104.
[12] Decision (D).13-02-015, Findings of Fact 50-55, p 126. See also Conclusion of Law 21, p 130. In this decision, the Commission also once again rejected a CAM opt-out, stating that the record is insufficient to resolve outstanding questions. Conclusion of Law 23, p 130.

Incentives for Choice of Procurement

Besides any issue of the equity of placing responsibilities for grid generation and reliability on the IOUs and allocating some cost to the CCAs and Direct-Access customers, there is also an efficiency issue. Power and energy sources with secure supply and strong reliability attributes may cost more to procure than sources without such attributes. But they provide no more benefit to the CCAs and Direct-Access customers, for the CCAs and the Direct-Access customers must – by law and by policy – pay for those attributes to be purchased on their behalf by the IOUs. Even if a CCA could purchase fully dependable generation resources at a cost below the cost of its host IOU, it would have no reason to do so, for it must pay for the generation assigned to it by the Commission. Its incentive, therefore, is to purchase power without back-up and without any other attributes that would contribute to a more reliable grid unless those attributes were absolutely free.

The Most Recent Decisions of the Commission

There have been two decisions of the CPUC in the Long-Term Procurement Proceeding, (R).12-03-014 in 2014 that may serve to limit the amount and extent of future CAM charges.

Decision (D).14-03-004 limits the geographic range of the CAM allocation related to the departure of the SONGS generating units from Southern California's generation mix.[13] The Commission determined that the Long-Term Procurement Proceeding relating to the closure of SONGS should be allocated only within the service area of the IOUs directly affected by the local need, and not allocated across the entire state. SONGS is located in Southern California and was a major element in the capacity planning of the Southern California Edison Company (SCE) and the San Diego Gas and Electric Company (SDG&E). The effect of the plant's retirement on local reliability is primarily a local matter with implications for SCE and SDG&E and the customers located in their service areas. The decision states: "We find that the procurement authorized in

[13] Decision (D).14-03-004 in Proceeding (R).12-03-014.

this decision is for the purpose of ensuring local reliability in the SONGS service area, for the benefit of all utility distribution customers in that area. … Therefore, SCE and SDG&E shall allocate costs incurred as a result of procurement authorized in this decision, and approved by the Commission."[14] That means that CCAs outside of the SCE and SDG&E service area, such as the Marin Energy Authority (MEA), would, under this proposed decision, not share in CAM related to SONGS local reliability. [15]

Decision (D).14-02-040 instructed the IOUs to make use of the Open Season and Binding Notice of Intent (BNI) process. Under the previous rules, the IOUs were to procure according to their forecasts, including their forecasts for departing load (the load of the Direct Access Customers and Community Choice Aggregators). The Alliance for Retail Energy Markets and the Direct Access Customer Coalition (AREM/DACC) recommended that the IOUs should be required to estimate reasonable levels of expected departing load over the 10-year term of the bundled plans of Direct Access (DA) customers and Community Choice Aggregators (CCAs). The decision states: "We agree with the concept expressed by most parties that the IOUs should plan for reasonable amounts of departing load in their bundled plans and then only procure for the assumed amounts of retained bundled load."[16] What is reasonable? The decision notes that "For CCAs specifically, the Commission has adopted an Open Season and Binding Notice of Intent (BNI) process to trigger the exclusion of potential CCA load from IOU bundled procurement. … Once a CCA has submitted a BNI, its customers are no longer responsible for utility bundled procurement cost incurred after that date..."[17] Requiring IOUs to procure in a reasonable manner to the forecasts of the CCAs may have the effect of reducing the amount of procurement subject to the CAM.

Those two decisions carry a benefit to CCAs and to AREM/DACC in that each contains a limitation on the CAM. But neither offers any fundamental change in the structure of the CAM.

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[14] Decision (D).14-03-004 cited, Page 120.
[15] The Alliance for Retail Energy Markets and Direct Access Customer Coalition have filed a Petition for Modification of Decision (D).14-03-004.
[16] Decision (D).14-02-040, Section 4.2.3, p 16.
[17] Decision (D).14-02-040, Section 4.2.3, p 16.

Moving Beyond Generation

There is an additional factor that appears in the latest LTPP decision that may be relevant for this discussion of the burden of the Cost Allocation Mechanism. In decision (D).14-03-004, the Commission authorizes a "range of procurement … intended to provide flexibility to meet a variety of circumstances."[18] It is not just generation, but preferred resources and all characteristics of a reliable grid that are authorized in this decision.

Proposal for a More Fundamental Change

There may be another way of fundamentally altering the way that the CAM is structured so as to provide a benefit to all parties. As early as 2004, the Commission encouraged "cities and counties that are seriously considering CCA to approach their IOU and proactively consider strategies in which the two parties can share procurement risk going forward. … We support parties working together to seek the most efficient transaction between the IOU and CCA."[19]

Consider that there are two fundamental issues of the CCAs and Direct Access Providers regarding the CAM: Reciprocity and Authority.

- *Reciprocity:* The mechanism for CAM is a one-way tool only. It exists for the IOUs to purchase resources on behalf of all who rely on the electric grid, including direct access customers and the customers of the CCAs. It allows for the IOUs to spread costs of generation resources to the CCAs (whether a CCA wants the benefit of those resources or not). CCAs on the other hand, do not have any mechanism to make purchases of resources on behalf of all electric grid customers. This may be referred to as the "reciprocity" issue.

[18] Decision (D).14-03-004, p 117.

[19] Decision (D).04-12-048, Finding of Fact 29, pp 201-202. That decision also made it very clear that the Public Utility Code requires cost recovery from CCAs and other departing load. See Conclusions of Law 12, 13, and 14, pp 228-229.

- *Authority:* There is no way for a CCA or Direct Access Customer to demonstrate that it has made its own arrangements for its own resources and that it does not need any resources to be purchased on its behalf. It can *assert* that it has made its own arrangements. But it has no forum, such as a CPUC courtroom, in which it can compare its own resources to those of the IOU and receive an authoritative conclusion that it is fully resourced. That may be referred to as the "authority" issue.

The proposal of this memorandum is that the CPUC invite the parties to agree to deem the CPUC to be the authority for review of the adequacy of the resource procurement of direct access customers and CCAs as well as of the IOUs. For the purpose of evaluating the characteristics of long-term power resources, the Long Term Procurement processes of the CCAs and direct access customers could become part of the overall long-term procurement processes of the Commission overall. If, for example PG&E and MEA were to present long-term proposals together in the same proceeding, subject to the same oversight of the Commission, in the spirit of the 2004 decision quoted above, the Commission would be able to deal with both reciprocity and authority. Similarly, if a direct access provider or an ESP were to bring its procurement contract to the CPUC for a review of its performance characteristics and contribution to the security of the grid, the Commission may be able to determine that no additional security would be necessary. However, in the absence of any such agreement among parties, the Commission does not appear to have the ability to accept the assertions of either CCAs or of direct access providers or ESPs regarding the characteristics of their resources.

For the Commission to take on this burden there may need to be a preliminary decision that it is in the best interest of all parties. It may be that the Commission, which is legally required to oversee the procurement of the IOUs, could find it within the meaning of the Public Utility Code, particularly those parts of the code that deal with CAM, to evaluate the procurement plans of CCAs in the same proceedings. In that way, the resource contracts of, say MEA and of PG&E could be evaluated side-by-side, and it could be determined whether, and to what degree, any costs need to be allocated, and in which direction the allocation should go. It is entirely possible that, given the joint review of their procurement, both MEA and PG&E would find it in their interests to collaborate in their purchases and in their solicitations for resources. Total costs may be reduced.

The benefits of this type of arrangement can be summed up in the idea of a unitary regulatory authority with responsibility to evaluate resources and a well-established ability and willingness to exercise that responsibility. The Commission would then be in a position to deal with any reciprocal cost issues in a fundamentally fair way. The cost is only that there may be some additional burden on CPUC Energy Division staff. There would be little if any additional burden on MEA or any other CCA, for MEA and DACC are already parties in CPUC proceedings. By participating as purchasers of resources, they would find themselves on a footing much like that of PG&E and the other IOUs.